No. 12611

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

United States of America,

Appellant,

vs.

California Electric Power Company, a corporation,

Appellee.

Upon Appeal From the District Court of the United States for the Southern District of California,

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BRIEF FOR APPELLEE.

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TOPICAL INDEX.

TABLE OF AUTHORITIES CITED.

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BRIEF FOR APPELLEE.

Statement.

The facts were stipulated and were specially found by the District Court, as stated by appellant in its brief.

Summary of Argument.

It is respectfully suggested that the appellant in its brief (pp. 6-7) in stating the question at bar to be "* * * whether in the circumstances presented a certain issue of cumulative preferred stock was subject to the tax in its entirety as being an 'original issue' within the meaning of the statute, the Regulations, and the pertinent decisional authorities, or whether, as the taxpayer contends and as the court below held, the tax was imposable on only a part of the shares," has assumed what the appellee contends and believes is the very point in dispute. In this statement, and time after time in its brief, appellant refers to the

transactions here in question as that "certain issue" of stock as though there were no question but that only one single transaction were involved. Actually, as viewed by the appellee and apparently by the trial court, the real question is whether the two transactions in question were sufficiently separable so as to allow an allocation between them to be made. Appellee therefore respectfully submits for the consideration of this Court that the question at bar can be more precisely and accurately stated as follows: Whether the issuance of new preferred stock in exchange for old preferred stock constitutes an "original issue" of stock where the old stockholders have the option, independent and separate from this exchange, of accepting or refusing additional shares of new preferred stock to be issued in partial settlement of dividend arrearages on the old preferred stock. Appellee believes that to pose the question in this form is to answer it, in its favor.

Regardless of how the problem is stated appellee submits that the transactions here involved were not only sufficiently separable to permit an allocation to be made between the old and the new capital but that such allocation was in fact made and was implicit in the two transactions from their inception. The conversion of each share of old preferred stock into 4/5 share of new preferred stock and 6 shares of common stock was automatic, mandatory and instantaneous on June 30, 1941. It covered a certain definite invariable amount of capital, viz., $11,-349,130, no more and no less. It was not a taxable transaction.

The other transaction was optional, voluntary and elective as to the several stockholders and involved progressive accretions to capital and issues of stock which were taxable as made from time to time in total amount by what-

ever was the excess above $11,349,130. Indeed it requires some acumen and effort to combine or confuse these two transactions.

The appellant in effect concedes that if the transactions are separable, no tax will apply to the exchange of new for old preferred stock when it says (Brief p. 7): "Had this been the whole of the transaction, there would have been no tax payable, because no increase of capital would have been thereby effected."

Appellant then asserts that this was not the whole of the transaction (Brief p. 7) because "simultaneously" the directors made an offer to issue new stock in partial payment of dividend arrearages. It is respectfully submitted that this conclusion is erroneous both in fact and in law, because the two transactions were authorized by two different groups, at two different times, in separate meetings, and were consummated at different times.

Finally, the appellee will attempt to correct what apparently is a misunderstanding on the part of the appellant of appellee's argument with respect to the amendment of the law applicable to such transactions. Appellee does not now and has never claimed that the amendment in question has retroactive effect, nor does the appellee ask the Court to "provide relief for taxpayers before the date that the legislature has seen fit" (Brief p. 8). The appellee has merely pointed out that where the Congress has acted to prevent inequities in the future, the Court is certainly empowered to refuse to extend the application of the Commissioner's repudiated doctrine to cases not squarely within that doctrine.

ARGUMENT.

The appellee has no fault to find with the statement of legal principles in appellant's brief in the first paragraph on page 9, assuming, of course, that there has been, in each case, only one exchange or other similar transaction. In the second paragraph on page 9 appellant states that an entire new issue is taxable "unless definite shares can be identified as having been issued against the increase in capital." If appellant means to imply that by "definite shares" is meant specific identification of each share by its number and the date and page of the journal entry under which that share is issued and capital added, then appellee believes that the cases cited do not stand for any such principle, as will be pointed out in later analysis of those cases. The Courts should not be burdened with such voluminous, detailed accounting records. If the statement means, however, that a "group" or "block" or "issue" of stock must be associated and identified with a capital addition then the appellee agrees therewith.

Appellee likewise agrees with the appellant's statement of facts on page 11 of its brief concerning the exchange of new for old preferred stock. The point at which the appellee and appellant part company is in the description of the issue of preferred stock in partial satisfaction of dividends, and the legal conclusions to be drawn therefrom.

Appellant treats the exchange of new for old preferred stock, and the issuance of stock in partial satisfaction of dividends, as one single, inseparable transaction. The facts simply do not support this treatment. The exchange of stock was authorized by an amendment to the appellee's Certificate of Incorporation adopted at a meeting of the stockholders on June 20, 1941 [R. 29 and 34]. This exchange took place *automatically* on June 30, 1941, inde-

pendent of any further action by any stockholder, of either an affirmative or negative nature [R. 29]. *"This was the sole and only change made in the capital structure by said amendment to the Certificate of Incorporation."* [Stipulation R. 29.] On an entirely different (and earlier) date, May 29, 1941, a different group (Board of Directors) had offered to issue additional shares of stock to any preferred stockholder who consented thereto in partial satisfaction of unpaid dividends due that stockholder [R. 62-63].

Some, but not all, of the stockholders accepted the offer of additional new stock in lieu of dividends, at various times during the ensuing six months. Upon acceptance of this offer new stock was issued, as stipulated [R. 30], *"if, as and when* the dividend arrearages were waived, and *in exchange therefor.* * * *" (Italics supplied.)

Obviously it was possible for a stockholder to take part in the "conversion" without taking part in the other transaction—the new issue of stock in exchange for dividends. That some stockholders actually did this is shown by the stipulation [R. 31, par. 9(b)].

The fundamental error of appellant's position is well illustrated in its brief (p. 12) where, after discussing the automatic conversion of old into new stock, it says "Then and coextensively, as to the new preferred, the taxpayer increased the thus reduced preferred stock account by adding thereto the accumulation of $1,047,230 in dividends, against which it issued one-fifth of a share of new preferred, amounting to a par value of $10 and which completed the $50 value of each new share of preferred."

New capital was not added "then and coextensively" with the automatic conversion. There was no change in capital structure by reason of the stock conversion authorized by the amendment to the appellee's Certificate of Incorpora-

tion [R. 29]. New capital was added "if, as and when dividend arrearages were waived, and in exchange therefor. * * *" [Stipulation R. 30].

Appellant insists that the addition of new capital caused a "commingling" of old and new capital. This is believed to be no more true than to say that any issue of additional stock which thereby increases capital causes commingling. To illustrate suppose that a corporation accomplished a share for share exchange of par value preferred stock, thereby causing no change in the capital stock account. Suppose further that the stockholders were given the option to purchase additional shares of preferred stock at par for cash. Shareholder X owns five shares of preferred stock, par value one dollar each. He exercises his option at or near the time of exchange and purchases five additional shares of preferred stock for cash at par, one dollar each. His cash is added to and "commingled" with the capital of the company. It is believed that any accountant would say that the only new thing entering the capital account would be the cash so received, and would have no difficulty in segregating the old capital from the additional capital against which new shares were issued. The value per share of his stock has not been changed either by the exchange or the issue of additional shares for new capital. Does it matter that in the present case claims were waived rather than cash paid for the additional stock?

Returning to the instant case, let us view these two transactions for a moment from the standpoint of the non-consenting shareholder.

Has such a stockholder's claim in dollars against the capital stock account been changed in any way by the automatic conversion of stock? Obviously not. Has the value of his stock been increased or changed in any manner

by the transfer of capital to the stock account (bearing in mind that for each dollar added to the stock account new stock in exactly that amount is issued on an if, as and when basis) to cover additional shares issued? Again, obviously not.

Perhaps the transactions as viewed by the appellee can be epitomized in the language of the trial court as follows [R. 66-67]:

> Stated simply for the purposes of illustration, the two transactions may be compared as follows: If shareholder A had 50 shares of the original preferred stock, following the amendment he now has 40 shares of the new preferred stock. If he accepts the offer of stock for dividend arrearages he receives ten additional shares of the new preferred stock and $50.00 in cash. At the same time there is a transfer from surplus to the capital stock account of an amount equal to the share value of the 10 additional shares.
>
> If shareholder B had 50 shares of the original preferred stock, following the amendment he also now has 40 shares of the new preferred shares. If he does not accept the offer of the stock for the dividend arrearages he, of course, receives no additional shares and there is no transfer of any surplus to the preferred stock account. As to shareholder B, there has been no change except an exchange of old preferred shares for new preferred shares. His proportionate claim against the corporation's assets remains unchanged.

The essence of this illustration lies in the fact that the automatic conversion took place regardless of shareholder B's non-acceptance of the option to acquire additional stock. In other words, the first transaction (authorized by a different group, on a different date, and to be consum-

mated at a different time) could and did happen independently of the action of shareholders on the offer of additional stock, and without changing the dollar value of his claim on the company's assets.

The appellee therefore asserts that the two transactions were sufficiently separable that no new capital could be said to have been added by the automatic conversion of stock. New capital was added only if, as and when, and to the extent, that stockholders accepted new stock. Accordingly, only the stock issued against the new capital is subject to the original issue tax.

Let us now examine the cases upon which the appellant relies for its assertion that the trial court's conclusions regarding this case are not in keeping with the law applicable thereto (Brief p. 15).

Appellant understandably attempts to bring the present case within the law laid down by this Court in *Southern Pacific Co. v. Berliner,* 176 Fed. 2d 671, and *Rio Grande Oil Co. v. Welch,* 101 Fed. 2d 454. Neither of those cases is in point. Briefly, the reason is that the fundamental issue in each of those cases was whether *any* new capital was added as a result of an admittedly single transaction. Here there is no question that new capital was added, but the issue is whether stamp tax is due upon a conversion of old into new stock merely because additional shares representing new capital are issued in a *separate transaction.*

Since the appellant has chosen to rely so heavily on those two cases a more thorough examination of their respective facts is in order.

In *Southern Pacific,* the company exchanged stock having a par value of $100, share for share for new no-par stock and simultaneously transferred into the capital ac-

count $6,304,845. It is perfectly obvious that the equity or share value of *each share* is thereby increased from $100 to $100 plus its pro rata share of the new capital. In other words, the asset value of each share included both old and new capital. The intermingling of old and new capital was clear and the trial court properly so found. On appeal, the company abandoned this issue and relied entirely upon the proposition that the $6,304,845 was not new capital because it was for practical purposes always a part of capital. This Court accurately and concisely stated that the issue "* * * narrows down to the single question whether the Commissioner was right in finding that the exchange effected an increase in capital account" (p. 673), and decided only the issue as to whether this amount added by this single transaction was new or old capital, rightly concluding that it was new capital because it represented money previously available for dividends now capitalized.

Here the appellee does not deny that new capital was added by the issuance of new stock in partial satisfaction of dividend claims. Appellee does deny that any new capital was added as a result of the conversion of old into new stock. Clearly this is so because the equity value or proportionate claim against the company's assets is unchanged thereby. Indeed the parties have stipulated that (referring to the conversion) "This was the sole and only change made in the capital structure by said amendment to the Certificate of Incorporation." [R. 29.] It is solely upon the conversion that appellee's claim for refund of stamp tax is based. The mere fact that by another and separate transaction new and additional stock was issued to some, but not all, of the stockholders in exchange for dividend arrearages, and in the amount of the arrearages settled thereby, does not serve to increase

the equity value or share value or add to the capital back of the previously converted shares. The new capital is added only if, as, and when new shares are issued for dividend arrearages. In *Southern Pacific* the equity value of each new share was increased by its share of the new capital because it was no-par stock. Here the new capital is represented by claims against it in the form of new shares having par value equal to the new capital. This is a vital distinction between the two cases.

Southern Pacific would be here in point only if in that case new shares of the same share value had been exchanged for old, and then additional shares had been issued against the new capital. This, of course, did not happen.

Southern Pacific is, therefore, not in point as was recognized by the trial court.

Again in *Rio Grande Oil Co.,* referred to by appellant as an *a fortiori* case, the primary issue was not whether intermingling had occurred but whether *any* new capital had been added by the transaction. The problem arose out of the transfer of appreciation surplus to the stock account in connection with an exchange of stock. The company had issued 5 shares of new *no-par* stock in exchange for one share of *$25.00 par stock* and at the same time transferred a large sum to the stock account. If this transfer to stock account in fact amounted to addition of new capital then it is obvious that the 5 shares of new stock now represented, not $25.00 as before, but a new equity value of $25.00 plus the pro rata share of new capital. In other words, each share was a claim against both old and new capital. The Court therefore stated the issue to be "whether the exchange made by the appellant was effected without increase of its capital" and found that such an

increase had occurred because the value of each share was increased by the new capital. Only one exchange of stock was there involved, rather than two exchanges as here. In the instant case the conversion of old into new stock did not in itself increase the equity or book value of the stock, nor was the equity or book value of the exchanged shares affected in any manner by the issue in another and separate transaction of additional shares and the appropriation of new capital to those shares if, as, and when issued. The *Rio Grande* case would only be in point had the exchange of new stock for old stock in that case been effected (without changing its asset value or par value) and then additional shares issued if, as, and when the additional capital was dedicated.

It is believed that the differences in the legal issue presented, as well as the factual differences, are sufficient to justify what the appellant terms the "bald statement" of the trial judge (Brief p. 20) that *Rio Grande* is "clearly distinguished from the present case on the facts." (Brief p. 20.) In addition to being informed by briefs of counsel in the cause below, it is suggested that the trial judge in the preesnt case was thoroughly familiar with the facts of *Rio Grande* inasmuch as that judge was, as United States Attorney, one of the counsel for the United States Government in the *Rio Grande* case.

We proceed now to examine what the appellant asserts is the case most nearly in point factually, *American Gas & Electric Co. v. U. S.*, 69 Fed. Supp. 614 (S. D. N. Y.).

That *American Gas & Electric Co.* is distinguishable from the present case is apparent from an examination of the facts there involved. There the company had outstanding a number of shares of *no-par* stock which had been issued at varying prices. The company issued the

same number of shares of new stock of par value $100 and transferred to capital from surplus an amount equal to the difference between the par value of the new shares and the *average* book value or capital stock liability of the old shares. A further adjustment to the capital account was made by adding thereto from surplus an amount equal to the difference between par and *average* book value of some 39,162 of the new shares issued to the public through underwriters for cash, at par. The Court held the entire issue taxable as an original issue, since the new and old capital was mingled and no shares could be identified or segregated from the others. In that case each new share, when issued, immediately represented an interest in capital with a new and different value, while in the case at bar the exchange of new for old stock (both of par value) in and of itself effected no change in the capital account or the value of the stock itself. Furthermore, the other transaction by which stockholders could waive dividends and receive new stock did not change the value of the stock exchanged by so much as one dollar—new stock being issued and new capital being added dollar for dollar.

Actually *American Gas* and *Southern Pacific* are perfectly in harmony, representing merely two sides of the same coin. In *Southern Pacific* the exchange was of par for no par stock and the addition of new capital, so the share value of *each share* was par plus pro rata value of new capital. In *American Gas* the exchange was of no-par for par stock and the addition of sufficient new capital so that the share value of each new share was old value plus new capital which equalled the new share value of par. In both of the cited cases it is clear that each share's value is changed by the addition and intermingling of new capital and old. In the instant case the conversion of old

into new stock caused no change in share value. At the conclusion of that conversion the share or par value of each share was $50, regardless of whether any shareholder elected to take additional shares in lieu of dividends. That share or par value remained $50 regardless of when or how many new shares were issued at $50 each. This value remained unchanged at $50 even though additional shares were issued in cancellation of dividends.

American Gas will be further discussed in connection with the analysis of *U. S. v. Pure Oil Co.,* 135 F. 2d 578, below.

The appellant contends that the *Pure Oil* case is distinguishable from the present one on its facts (Brief p. 23), but that if not distinguishable then the *Pure Oil* case is wrong (Brief p. 25).

The appellant then devotes some considerable space to arguments concerning the correctness of that decision. Perhaps the best answer to this contention is furnished by the statement of the trial judge in his opinion [R. 69] where in reference to *Pure Oil* he said:

> The government criticizes this decision, at the same time it did not endeavor to justify its attempted exaction of over $20,000.00 by applying for a writ of certiorari. It is interesting to note that Circuit Judge Minton, now a member of the Supreme Court of the United States, concurred in said opinion.

An additional statement from the opinion of the trial judge indicates that both this Court and the trial court in the *Southern Pacific* case probably considered that case and *Pure Oil* not in irreconcilable conflict.

> In the *Southern Pacific* case Judge Healy did not mention the *Pure Oil* case, which indicates he recog-

nized that factually they were not comparable. The failure to refer to it was intentional as it was cited on another point in the opinion written by Judge Roche in the District Court in *Southern Pacific Co. v. Berliner,* 78 F. Supp. 696-697. [R. 70.]

Further evidence that *Pure Oil* correctly stated the law is the fact that in *American Gas* the Court not only distinguishes *Pure Oil* at pages 619-620, but cites *Pure Oil* with approval at page 618 and intimates that on similar facts it would follow the *Pure Oil* case, at page 620.

The *Pure Oil* case is believed by the appellee to be almost precisely in point here, and the following quotation from the Court's opinion therein sets out the facts and conclusions of law most adequately.

> On April 1, 1936, defendant had outstanding certain shares of preferred stock on which there were unpaid accumulated dividends, on 8 per cent stock, of $25.50 per share, on 6 per cent stock, $19.125 per share. Defendant proposed, and its shareholders agreed, their certificates be exchanged, share for share, for equal shares of new perferred stock, paying a lower dividend, plus additional shares of new stock in satisfaction of the unpaid dividends. As a result, 264,226 shares of outstanding preferred stock were surrendered and an equivalent number of shares of new preferred delivered to the holders, who received also 56,115 shares of new stock in satisfaction of unpaid dividends.
>
> * * * Defendant recognized that the shares issued in satisfaction of unpaid dividends were within the term "original issue" and paid the tax upon them. The Government contended, and the trial court found, that the certificates for 264,226 shares issued in exchange for outstanding stock constituted likewise an

original issue. The propriety of that conclusion is now questioned.

The statute clearly indicates that, to be taxable, certificates must be, in point of time, the first issued, whereby the issuing corporation certifies ownership by its shareholders of their aliquot parts of the capital represented by the certificates. By specifying "original issue" we think it clear that the Congress did not intend to tax each issue but only that which precedes all other issues subsequently made when original certificates are surrendered and new ones delivered in their place to the same shareholders for no new monetary consideration. *Edwards v. Wabash Railway Co.,* 2 Cir., 264 F. 610. Nor do we think it of any importance whether shares are converted into identical or variant stock or whether preferred is exchanged for common or common for preferred, with resulting differences in rights and privileges, for the test is not whether the reissue is of different type but, rather, whether it is "original".

It was to defendant's interest to liquidate its unpaid accumulated dividends and to bring about a lower dividend for the future. When, with this end in view, defendant issued an equal amount of new stock for that part of the corporate assets represented by previously existing shares, it made no addition to its capital. It accomplished nothing other than replacement of older preferred stock with new, smaller dividend stock; the holders retained the same proportionate interests in the capital assets. The additional shares issued in satisfaction of unpaid dividends represented the only contribution to capital effectuated; that and that alone was an original issue. *Edwards v. Wabash Railway Co.,* 2 Cir. 264 F. 610; *Trumbull Steel Co. v. Routzahn,* D. C., 292 F. 1009; *Routzahn v. Trumbell Steel Co.,* 6 Cir. 300 F. 1006; *West Virginia*

Pulp & Paper Co. v. Bowers, D. C., 293 F. 144, affirmed 2 Cir., 297 F. 225, certiorari denied 265 U. S. 584, 44 S. Ct. 459, 68 L. Ed. 1191; *Standard Manufacturing Co. v. Heiner,* D. C., 300 F. 252; *Cuba Railway Co. v. United States,* 60 Ct. Cl. 272; *Cleveland Provision Co. v. Weiss,* D. C., 4 F. 2d 408; *In re Grant-Lees Gear Co., Bankrupt,* D. C., 1 F. 2d 393.

The Government insists that the entries upon the corporate books fail to disclose any shares specifically designated as a substitution for old certificates. It suggests that inasmuch as no shares were issued in lieu of any certain specified shares and no specific certificates charged against capital or surplus, it is impossible to classify the entire new issue as other than original. But book entries alone are not decisive. *Rio Grande Oil Company v. Welch,* 9 Cir., 101 F. 2d 454. And, so here, we receive no enlightenment from the formal ledger capital set-up. The undisputed fact is that the old preferred stock was exchanged share for share and the dividend arrears satisfied by issuance of additional shares. Whatever the book entries, the only new thing that could properly have gone into the capital account was the contribution by the shareholders of their unpaid dividends to the corporation in consideration of which they received the additional shares.

To the appellee the *Pure Oil* case seems almost squarely in point—certainly more nearly so than *Southern Pacific* or *American Gas & Electric Co.* If anything the case of the appellee is somewhat stronger than that of the taxpayer in *Pure Oil* because here the stockholders had the option to take or refuse the additional shares.

The appellant understandably seeks to distinguish the *Pure Oil* case but rather surprisingly asserts that this case differs from *Pure Oil* in the "same material respect

as the facts of *American Gas* differed from those of *Pure Oil*." (Brief p. 23.)

Appellee quotes herewith the identical quotations from *American Gas* cited by appellant in its brief, pages 23-24:

> Plaintiff contends that the transaction here was clearly analogous to the transaction in the *Pure Oil* case. *It says that the only distinction between the two cases is that here plaintiff, instead of using the amount transferred from surplus to capital as the basis for issuing additional shares as a dividend [as was done in Pure Oil], used it as the basis for increasing the capital liability per share from $94 to $100; that, in other words, instead of issuing one new share representing the same capital liability of $94 as the old share, and a separate share representing a capital liability of $6—as it might have done—it issued a single share representing a capital liability of $94 plus $6.*
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> *But this distinction is important.* * * * (Italics supplied.)
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> * * * * * * * *
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> The fallacy in plaintiff's position is that it takes an average and assumes that each old share exchanged represented a capital liability of $93.9995 per share. If that were so, the amount transferred from surplus to capital might be treated as a distribution or a divident, upon each share and an allocation made between the shares issued in payment of such distribution or dividend and the shares issued in exchange for the old stock, as was done in the *Pure Oil* case. But that is impossible here. for the shares as to which such a distribution or dividend might properly be said to have been made cannot be identified and segregated from the others. * * * (Italics supplied by appellant.)

Appellant then correctly interprets the *American Gas* decision as saying that the *Pure Oil* decision concerns in reality two separate transactions and further admits that "perhaps the result in the *Pure Oil* case was correct" because of the ability to identify definite shares issued against the increased capital. (Brief pp. 24-25.) Appellee believes the same ability to identify definite shares as in the *Pure Oil* case exists here.

Appellant then states (Brief p. 25):

> On that basis the instant case is certainly to be distinguished from *Pure Oil,* where the Court of Appeals said (p. 579) that the undisputed "fact" was that the old preferred stock was exchanged share for share and the dividend arrears were satisfied by issuance of additional shares—albeit at one and the same time.

Appellant does not then say how our case is to be distinguished from *Pure Oil* or analogized with *American Gas* but rather proceeds to dispute the rationale of the *Pure Oil* case. In other words appellant states that the present case is like *American Gas* rather than *Pure Oil* but instead of *distinguishing* this case from *Pure Oil* proceeds to *attack* the *Pure Oil* case.

Let us return to the portions of the *American Gas* opinion quoted above and see wherein they apply to this case. As pointed out in the italicized portion, the new capital in *American Gas* was *used to increase the capital liability per share from 94 to 100 dollars.* In *Pure Oil* the *capital value per share remained unchanged* and additional shares were issued against the additional capital, thus causing no change in capital value per share. In the present case the capital value of $50 per share established upon the conversion was not changed one iota by the issuance of additional shares against equivalent

amounts of new capital at the rate of $50 per share. In other words, the share value of $50 remained that value, regardless of whether no shareholder accepted the additional stock or whether some or all shareholders accepted the offer.

American Gas is also clearly distinguished from the present case in that there, only one transaction was involved and the taxpayer there never even contended otherwise. The argument there was that the tax should be measured only by the increase in capital liability per share (*cf.* above quotation from opinion). There was no such increase in capital liability per share in this case.

Appellee contends that *American Gas* is not in point and furthermore that the same distinctions there pointed out by the Judge between it and *Pure Oil* serve to distinguish *American Gas* from the present case.

As mentioned before briefly, the appellant repeatedly asserts (Brief pp. 9, 14, 20, 26) in slightly varying terminology that the tax must be imposed unless definite or specific shares can be positively identified as having been issued against specific segments of new capital. As authority therefor it quotes three decisions of Circuit Courts and two District Court decisions (Brief p. 9). Careful perusal of the three Circuit Court decisions cited (*Southern Pacific, Rio Grande Oil Co.* and *W. T. Grant Co. v. Duggan,* 94 F. 2d 859), does not reveal any such statement as having been made by the Court in any of these cases. (In *Southern Pacific* the Court states something similar as an argument of the Commissioner.) It is conceded that in the two District Court decisions cited (*American Gas* and *Southern Pacific v. Berliner,* 78 Fed. Supp. 696) statements along this line were made. In *Southern Pacific* (District Court) the language was "* * * with-

out any allocation of specific shares to such transferred sum * * *". (Appellant's Brief p. 17) and in *American Gas* the Court's statement which refers to identification or segregation of shares is immediately preceded, as shown by the above quotation from that case, by the Court's statement that the sort of allocation which the Court had in mind might be made in the *Pure Oil* type of case.

It is worthy of note that in each of the five cases cited by appellant on this point only one transaction admittedly was involved, and in every such case the capital value per share was increased by the new capital. In the only case, *Pure Oil,* where two transactions were involved, as here, and where the capital value per share, as here, was unchanged by the issuance of additional shares, the Court definitely rejected the Commissioner's specific identification argument in the following manner:

> It (the Government) suggests that inasmuch as no shares were issued in lieu of any certain specified shares and no specific certificates charged against the capital or surplus it is impossible to classify the entire new issue as other than original.
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> * * * * * * * *
>
> The undisputed fact is that the old preferred stock was exchanged share for share and the dividend arrears satisfied by issuance of additional shares. *Whatever the book entries, the only new thing that could properly have gone into the capital account was the contribution by the shareholders of their unpaid dividends to the corporation in consideration of which they received the additional shares.* (Italics supplied.)

It is respectfully submitted that the Courts have applied the allocation or identification argument so as not to re-

quire specific shares to be identified by number, page and journal entry, but only to require a reasonable identification of a block of shares with a segment of capital. It is the appellee's belief that it has met the burden of proof in this regard inasmuch as the new shares issued in lieu of dividend arrearages can be identified, and exactly the same possibilities of identification exist here as in *Pure Oil.* Indeed the parties have virtually stipulated that such segregation is possible when they stipulated (referring to the conversion of stock by the amendment of the Certificate of Incorporation): "This was the sole and only change made in the *capital structure* by said amendment to the Certificate of Incorporation." [R. 29] and that "* * * such new shares being issued *if, as and when the dividend arrearages were waived, and in exchange therefor.*" [R. 30.] (Italics supplied.)

Perhaps the best answer to the "intermingling" argument of appellant is furnished by analyzing its statement (Brief p. 20), which by virtue of italicizing it apparently considers quite important, in which it says: "Each new preferred stockholder, *regardless of whether he was one of those who had waived his right to the dividend arrearages,* received an interest in the newly augmented capital measured by the number of shares held."

The error of this conclusion is quite apparent, for if no shareholder had consented to accept new shares in lieu of dividends, and they were under no legal compulsion to do so, there would have been no "augmented capital," and even if others consented and one did not, his claim in dollars against the capital account was not changed by so much as one penny. His claim against the capital account was only changed if, as and when he waived dividends and accepted new stock in lieu thereof, and the

change was in exactly the amount of dividends satisfied by the new stock, and in exactly the amount of new capital added by virtue of his waiver.

Finally as to the effect of Congressional attempts to remedy the inequities of such decisions as *American Gas & Electric Co.* and *Southern Pacific Co.,* it is not and never has been the appellee's contention that the amendment to the Internal Revenue Code, Section 1802, effective August 8, 1947, was by its terms retroactive. Appellee does, however, contend that the following language from House Ways and Means Report No. 969 on H. R. 3613, is indicative of an intent to enact remedial legislation:

> This bill would amend three sections of the Internal Revenue Code relating to the stamp and document taxes on issues of capital stock and bonds, respectively. In general, it is designed to remove certain inequities arising under code sections 1802 and 3481. At present, in some cases, the tax imposed under section 1802 on capital stock issues, once levied, must be reimposed upon part of a new capital stock issue. . . .
>
> Your committee sees no justification whatever for permitting these inequities to continue. Their removal will greatly simplify present procedures and will have no material effect upon Federal revenues.

Conceding arguendo that this remedial statute has no retroactive application and only the "law" as it stood prior to its correction is to be considered in this case, we are presented with the question, "What is the 'law' in such cases?" Appellant argues that the "law" as expounded in *American Gas & Electric Co., Southern Pacific Co.,* and similar cases *must* be applied to the facts of the present case.

On the other hand appellee contends that the cases cited by appellant in support of its position are all distinguishable on their facts and that the case most nearly in point, *Pure Oil,* supports appellee's position. It should be noted that appellant makes no satisfactory distinction between *Pure Oil* and the present case but contents itself with the claim that *Pure Oil* is incorrect on the law. The best then that can be said for appellant's position is that in some jurisdictions cases with somewhat similar (but distinguishable) facts have been decided in its favor, while in another jurisdiction, upon facts almost precisely in point, the "law" was found to be in favor of the taxpayer. It is also worthy of note that the Bureau of Internal Revenue did not apply for certiorari in *Pure Oil* in order to resolve the "conflict" in law, if any there be. Appellee contends that *Pure Oil* is the "law" on these facts.

However, granting arguendo that the "law" is uncertain, then it is appellee's respectful contention that in cases of such uncertainty that reasonable minds and courts have differed, that the law, as applied in certain cases, which Congress has found to be inequitable, should not be extended beyond those cases to which it is clearly applicable. The present case on its facts, as hereinabove set forth, is not such a case.

In any event, regardless of the remedial legislation, appellee contends that the facts of this case bring it within the ambit of the *Pure Oil* case and place it outside that of *Southern Pacific.*

Conclusion.

The decision of the District Court is correct and should be affirmed.

Respectfully submitted,

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